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**Yield spread premiums and predatory loan calculations:
Wolski v Fremont Inv., 2005
Roger Bernhardt**

Predatory lending statute's definition of points and fees payable by borrower at or before closing does not include yield spread premium charged in connection with residential mortgage loan.

Wolski v Fremont Inv. & Loan (2005) 127 CA4th 347, 25 CR3d 500

Fremont Investment & Loan made a \$185,000 residential mortgage loan to Wolski. Later, Wolski discovered he could have obtained a loan with better terms, and sued Fremont under the predatory lending law (Fin C §§4970–4979.8), alleging that the loan, as a “covered loan” under the law (total points and fees payable at closing exceeded six percent of the loan amount), violated the law by failing to make certain disclosures and including a prepayment penalty. Fremont demurred on the grounds that the transaction was not covered by the predatory lending law, in that the total points and fees alleged by Wolski exceeded 6% of the loan amount only because he had erroneously included a \$3700 yield spread premium (YSP). The trial court sustained the demurrer without leave to amend, ruling that the YSP was not included in the definition of points and fees and, thus, the loan was not covered by the statute.

The Court of Appeal affirmed. Section 4970 covers only residential mortgages in which “[t]he total points and fees payable by the consumer at or before closing” exceeds six percent of the loan amount. The court examined the nature of the YSP, a bonus the lender pays to the loan broker who originates a loan at an interest rate higher than the minimum lender-approved interest rate for a particular loan. The difference between the higher actual rate and the minimum rate is known as the yield spread, and the YSP bonus is a percentage of the product of the yield spread and the loan amount. Though the lender pays the YSP to the broker, the borrower pays a premium rate over the life of the loan to compensate for the bonus. The court agreed with Fremont that the YSP was paid by the lender, not the borrower.

The court rejected Wolski’s argument that he was paying the YSP in the form of an increased interest rate, holding that to interpret the statutory phrase “at or before closing” to include interest payments to be made over the life of the loan would be a strained interpretation, and would render the words “at or before closing” surplusage in violation of the rules of statutory construction. Finally, the court examined the legislative history of the statute and found no specific references to YSP or anything else in the record to show that the nonexclusion of YSPs from the definition of fees and points would defeat the purpose of the statute. Accordingly, the court ruled that the YSP is not included in the predatory lending law’s definition of points and fees.

THE EDITOR’S TAKE: The exclusion of yield spread premium (YSP) points from the calculation of whether the loan is “covered” is made clear by the language of both the California statute (Fin C §§4970–4979.8) and its federal counterpart, the Home Ownership and Equity Protection Act of 1994 (HOEPA) (amending 15 USC §§1601–1693r) (Pub L

103–325, §151, 108 Stat 2190). Thus, the redefinition sought by the plaintiffs is going to have to come from the legislature rather than the courts.

Should that happen? Mortgage brokers take YSPs, theoretically at least, as compensation for the services they render in finding good loans for their borrowers. They would have to charge borrowers directly for those services were they unable to collect them indirectly from lenders as YSPs. For example, if a broker desires a \$1000 fee for its services in getting borrowers a loan of \$100,000, it can get that sum by either (a) finding a loan that, over its life, generates \$1000 extra interest to the lender, who would then pay \$1000 to the broker, as a YSP, or (b) requiring the borrowers to pay the broker \$1000 up front for finding them a loan that imposes that much less interest over its life. The lender doesn't care, since the bottom line is the same under either scenario.

Viewed in this light, the YSP is simply a matter of making it easier for people to borrow money, allowing them to reduce their front-end costs by spreading those costs over the life of the loan. Alternatively, borrowers can pay a little more at closing and pay a little less each month in interest. Of course, this must all be disclosed, but the YSP in and of itself is not a predatory tactic. A YSP, from this perspective, makes a loan covered (*i.e.*, predatory) only if it causes the overall interest rate to “exceed by more than eight percentage points the yield on Treasury securities having comparable periods of maturity,” rather than making the “total points and fees payable . . . at or before closing . . . exceed six percent of the total loan amount,” *i.e.*, the other test of predatory loans. This can be good or bad, depending on where you stand politically.

On the other hand, the same could be said for loan points themselves. Borrowers are usually given the choice of obtaining loans at different rates of interest with and without points paid up front. Those loans present the same kinds of economic equivalents as appear in YSP situations, except that, because the points are paid “at or before closing,” those loans qualify as “covered” under the statute. So why treat the economically similar yield spread premium differently? This is going to be a tough one for the legislature, should it try to take it up.— *Roger Bernhardt*